

Message Text

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PAGE 01 EC BRU 07139 01 OF 02 072030Z

71

ACTION EUR-25

INFO OCT-01 IO-14 ISO-00 SCEM-02 AID-20 CEA-02 CIAE-00

COME-00 EB-11 EA-11 FRB-02 INR-10 NEA-10 NSAE-00

RSC-01 OPIC-12 SPC-03 TRSE-00 CIEP-02 LAB-06 SIL-01

OMB-01 SS-20 NSC-10 INT-08 DODE-00 PA-04 USIA-15

PRS-01 DRC-01 /193 W

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R 071859Z DEC 73

FM USMISSION EC BRUSSELS

TO SECSTATE WASHDC 6134

INFO AMEMBASSY BONN

AMEMBASSY BRUSSELS UNN

AMEMBASSY COPENHAGEN

AMEMBASSY LONDON

AMEMBASSY LUXEMBOURG

AMEMBASSY PARIS

AMEMBASSY ROME

AMEMBASSY THE HAGUE

USMISSION GENEVA

USMISSION OECD PARIS UNN

C O N F I D E N T I A L SECTION 1 OF 2 EC BRUSSELS 7139

PASS TREASURY FRB AND CEA

E.O.11652: N/A

TAGS: EFIN, EEC

SUBJECT: ECONOMIC AND FINANCIAL CONSEQUENCES OF THE OIL

CRISIS -- VIEWS EXPRESSED AT EC COUNCIL (FINANCE)

AND BY COMMISSION OFFICIALS

REF: EC BRUSSELS 7035

1.SUMMARY: ACCORDING TO A PERM REP SOURCE, AT THE
HIGHLY RESTRICTED SESSION OF THE DEC 4 EC COUNCIL (FINANCE)

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PAGE 02 EC BRU 07139 01 OF 02 072030Z

(PARA 7, REFTEL), SCHMIDT SPOKE OF POSSIBLE SEVERE

DAMAGE TO THE COMMUNITY IF THE MEMBER STATES COULD NOT ACHIEVE GREATER SOLIDARITY IN THE PRESENT CRISIS, GISCARD IMPLIED THAT IT WAS MORE IMPORTANT FOR THE COMMUNITY TO AVOID ANTAGONIZING THE ARABS THAN TO MAINTAIN ECONOMIC SOLIDARITY OVER OIL WITHIN THE COMMUNITY, AND EC COMMISSIONER SIMONET SAID COMMISSION ESTIMATES INDICATED THE OIL SHORTAGE COULD LEAD TO A REDUCTION OF 2-3 PERCENT IN THE EC'S REAL GCP IN 1974 AND RAISE UNEMPLOYMENT TO A LEVEL OF 4-5 PERCENT. THE MISSION IS POUCHING TO STATE RPE TWO INTERNAL EC DOCUMENTS OBTAINED IN CONFIDENCE -- ONE PROVIDING A PESSIMISTIC ASSESSMENT OF THE ECONOMIC CONSEQUENCES OF THE OIL CRISIS, AND THE OTHER ANALYZING THE EFFECT OF OIL PRODUCER SURPLUSES ON THE EC BALANCE OF PAYMENTS. BECAUSE THESE PAPERS REFLECT THE SERIOUS CONCERN WITH WHICH THE COMMISSION VIEWS THE SITUATION, THIS MESSAGE SUMMARIZES THEM IN SOME DETAIL BEGINNING IN PARA. 6 BELOW. END SUMMARY.

2. A PERM REP CONTACT, WHO WAS DEBRIEFED BY SOMEONE WHO ATTENDED THE MEETING, HAS GIVEN US A BRIEF ACCOUNT OF WHAT WAS SAID AT THE HIGHLY RESTRICTED SESSION OF THE EC COUNCIL (FINANCE) DEC 4 (REFTEL). THE DISCUSSION CENTERED LARGELY ON THE OIL SITUATION. EMPHASIZING THAT HE WAS GIVING HIS PERSONAL OPINION, SCHMIDT REPORTEDLY SLAMMED THE COUNCIL'S RESOLUTION (REFTEL) ON INFLATION (WHICH OMITTED ANY REFERENCE TO THE OIL SITUATION) AS A DINNER MENU WITH LITTLE CONTENT. HE REGRETTED THAT THE COMMUNITY IN A TIME OF CRISIS COULD NOT ACHIEVE SOLIDARITY. HE SAID THAT IF THE SUMMIT COULD NOT ACCOMPLISH THIS, SEVERE DAMAGE COULD RESULT TO THE COMMUNITY. NOTING THAT THE U.S., JAPAN AND THE EC WERE ALREADY DRIFTING APART, HE SAID THE ENERGY CRISIS COULD ALSO GRAVELY DAMAGE THE LDCS. IT ALSO HAD THE EFFECT OF MAKING INTERNATIONAL MONETARY REFORM DIFFICULT IF NOT IMPOSSIBLE AT THIS TIME. ON THE OIL SITUATION ITSELF, HE URGED THAT THE COMMISSION PREPARE WITHIN TWO WEEKS (PRESUMABLY FOR THE DEC 17-18 COUNCIL MEETING) A NEW OVERVIEW THAT WOULD SHOW EXACTLY HOW MUCH OIL IS COMING INTO THE COMMUNITY AND WHAT

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PAGE 03 EC BRU 07139 01 OF 02 072030Z

RESERVES WERE STILL AVAILABLE.

3. GISCARD REPORTEDLY REPEATED THE KNOWN FRENCH VIEW THAT THE POLITICAL PROBLEMS RAISED BY THE OIL CRISIS COULD BE MORE IMPORTANT FOR THE COMMUNITY THAN ECONOMIC SOLIDARITY. (OUR CONTACT INTERPRETED THIS TO MEAN THAT IT WAS MORE IMPORTANT FOR THE COMMUNITY TO REMAIN ON FRIENDLY TERMS WITH THE ARAB STATES THAN TO TRANSFER

OIL TO THE NETHERLANDS.)

4. SIMONET, APPARENTLY PRESENTING A COMMISSION STUDY ON THE ECONOMIC CONSEQUENCES OF THE OIL SITUATION, GAVE A GLOOMY FORECAST. HE SAID THAT A 20 PERCENT PETROLEUM DEFICIT IN RELATION TO CURRENT NEEDS COULD LEAD IN 1974 TO A 10 PERCENT REDUCTION IN INDUSTRIAL PRODUCTION, A 2 TO 3 PERCENT DECREASE IN REAL GNP, AN INCREASE IN THE LEVEL OF UNEMPLOYMENT FROM 2 TO 4-5 PERCENT, AND A 1 TO 1-1/2 PERCENT INCREASE IN THE GENERAL PRICE LEVEL. HE ALSO SAID SUBSTANTIAL REPATRIATION OF DOLLARS COULD OCCUR. HE CALLED FOR THE COMMUNITY TO RESPOND TO THE SITUATION IN BOTH THE SHORT AND LONG-TERM.

5. THE MISSION HAS SINCE OBTAINED CONFIDENTIALLY TWO INTERNAL COMMISSION STUDIES. THE FIRST, WHICH WAS APPARENTLY THE BASIS FOR SIMONET'S PRESENTATION, EXAMINES THE ECONOMIC CONSEQUENCES OF THE OIL CRISIS, AND THE SECOND ASSESSES THE IMPACT OF OIL PRODUCER SURPLUSES ON THE EC'S BALANCE OF PAYMENTS. ALTHOUGH THE FIRST OF THESE PAPERS APPEARS TO HAVE LEAKED OUT TO THE PRESS ("LE MONDE," DEC 1, PAGE 42), THE DOCUMENTS ARE STILL BEING CLOSELY HELD AND OUR POSSESSION OF THEM SHOULD NOT BE REVEALED.

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PAGE 01 EC BRU 07139 02 OF 02 072052Z

71

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C O N F I D E N T I A L SECTION 2 OF 2 EC BRUSSELS 7139

PASS TREASURY FRB AND CEA

6. THE FIRST PAPER ON THE ECONOMIC CONSEQUENCES IS STARKLY PESSIMISTIC. IT STATES THAT A PROLONGED REDUCTION IN OIL SUPPLIES, EVEN IF ACCOMPANIED BY CERTAIN RESTRICTIONS ON NONESSENTIAL CONSUMPTION, COULD LEAD IN 1974 TO A DECREASE IN REAL GNP IN THE EC OF 2-3 PERCENT (AS STATED BY SIMONET ABOVE) INSTEAD OF THE 4.5 PERCENT INCREASE THAT HAD BEEN PREDICTED BEFORE THE CRISIS BEGAN. STATING THAT SUCH A REDUCTION WOULD CONSTITUTE THE MOST SERIOUS DECLINE IN ECONOMIC ACTIVITY IN THE COMMUNITY SINCE THE END OF

CONFIDENTIAL

PAGE 02 EC BRU 07139 02 OF 02 072052Z

THE LAST WAR, THE PAPER ADDS THAT ITS ESTIMATE MAY EVEN BE TOO OPTIMISTIC. THIS IS BECAUSE IT TAKES ACCOUNT ONLY OF PRODUCTION DECREASES TRIGGERED DIRECTLY BY SUPPLY SHORTAGES AND IGNORES THE SECONDARY EFFECTS SUCH SHORTAGES WOULD GRADUALLY HAVE ON DEMAND, A 2-3 PERCENT DECREASE IN GNP WOULD, IN TURN, RAISE THE LEVEL OF UNEMPLOYMENT TO 4-5 PERCENT COMPARED WITH THE PRESENT 2 PERCENT. AT THE SAME TIME AN INCREASE IN INFLATIONARY DEMAND PRESSURES COULD ALSO BE EXPECTED SINCE INCOME ADJUSTMENTS WOULD LAG BEHIND DECREASES IN PRODUCTION.

7. THE PAPER SAYS THAT IF ADEQUATE MEASURES ARE NOT TAKEN SOON, THE OIL CRISIS COULD HAVE GRAVE EFFECTS (SPELLED OUT IN GREATER DETAIL IN AN ANNEX) IN THE FOLLOWING AREAS -- EVEN IF THE OIL SUPPLY SITUATION IMPROVES BETWEEN NOW AND THE END OF THE YEAR -- (A) ECONOMIC: MARKED SLOWDOWN IN ACTIVITY AND EVEN PRODUCTION STOPPAGES, THESE OCCURRING MOREOVER IN A DISORDERLY AND UNEQUAL MANNER ACCORDING TO SECTORS AND REGIONS BUT AFFECTING THE COMMUNITY AS A WHOLE: (B) SOCIAL: REDUCTION IN WORK HOURS, UNEMPLOYMENT, AND IN THE LONGER TERM, DECREASES

IN REAL INCOMES: (C) MONETARY: RENEWED INFLATION, AND DISEQUILIBRIUM IN THE BALANCE OF PAYMENTS AND EXCHANGE RATES. BECAUSE OF THE INTERDEPENDENCE OF THE EC ECONOMIES THE RELATIVELY FAVORABLE SITUATION OF SOME MEMBER STATES WITH RESPECT TO SUPPLY WOULD NOT SHIELD THEM FROM THE PHENOMENA DESCRIBED ABOVE.

8. THE SECOND PAPER DISCUSSES OIL PRODUCER SURPLUSES AND THE EC BALANCE OF PAYMENTS. IT STARTS FROM THE ASSUMPTION THAT IN THE NEXT FEW YEARS THERE WILL BE AN ENORMOUS INCREASE IN THE TOTAL IMPORT BILL OF THE INDUSTRIALIZED COUNTRIES AS A WHOLE. GIVEN THIS CIRCUMSTANCE THE APPARENTLY VERY LOW PRICE ELASTICITY OF DEMAND FOR ENERGY AND THE ABSENCE OF ANY VIABLE ALTERNATIVE TO OPEC OIL DURING THE REMAINDER OF THIS DECADE, THE PRICE OF OIL WOULD PROBABLY RISE WELL ABOVE ITS PRESENT LEVEL BEFORE THE POSITIVE EFFECT OF HIGHER PRICES ON THE OPEC COUNTRIES' CURRENT ACCOUNT
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PAGE 03 EC BRU 07139 02 OF 02 072052Z

WAS OFFSET BY THE NEGATIVE EFFECT BUT JUDGES THEM CONSERVATIVE -- SINCE THEY ASSUME A PRODUCER PRICE FOR CRUDE OF ONLY \$4 A BARREL BY 1980 -- AND GOES ON TO FORECAST ON OPEC CURRENT ACCOUNT SURPLUS OF \$25 BILLION BY 1975 AND \$40-60 BILLION BY 1980 (AT 1973 PRICES), MOST OF THIS WITH THE OECD COUNTRIES. THE COMMUNITY WOULD PROBABLY BEAR A DISPROPORTIONATELY GREATER SHARE OF THE DETERIORATION OF OECD CURRENT BALANCES.

9. IN CONSIDERING THE CONSEQUENCES OF A MASSIVE DETERIORATION IN THE EC'S CURRENT ACCOUNT AND A POSSIBLE MASSIVE FLOW OF CAPITAL FROM THE OPEC COUNTRIES INTO THE COMMUNITY, THE PAPER POINTS TO THE TWIN DANGERS OF (A) EXTREME INCOMPATIBILITY OF BALANCE OF PAYMENTS AIMS OF INDIVIDUAL EC COUNTRIES OR BETWEEN THE EC AND OTHER INDUSTRIALIZED COUNTRIES -- WHICH MIGHT ENTAIL "BEGGAR-MY-NEIGHBOR" TRADE AND PAYMENTS POLICIES -- AND (B) FINDING ASSETS SUFFICIENTLY ATTRACTIVE FOR OPEC, WHOSE ABSORPTIVE CAPACITY IS LIMITED, TO ACQUIRE IN EXCHANGE FOR THEIR OIL.

10. THE PAPER VIEWS AS SELF-DEFEATING OR INFEASIBLE (A) THE POSSIBILITY OF THE EC TRYING TO MAINTAIN ITS CURRENT ACCOUNT POSITION AT THE EXPENSE OF OTHER OECD COUNTRIES AND (B) EC ATTEMPTS TO IMPROVE ITS CAPITAL ACCOUNT BY RESTRICTING CAPITAL OUTFLOWS OR THROUGH EXCHANGE RATE AND INTEREST RATE POLICIES. THE ONLY SHORT-TERM POSSIBILITY ADVANCED IS SOME FORM OF RECYCLING OF CAPITAL FLOWS FROM THOSE COUNTRIES WHOSE OFFICIAL SETTLEMENTS BALANCES HAVE IMPROVED -- AS A RESULT OF

A MORE FAVORABLE OVERALL PAYMENTS POSITION WITH THE
OPEC COUNTRIES -- TO THOSE WHOSE OFFICIAL SETTLEMENTS
BALANCES HAVE DETERIORATED.

11. THE PAPER THEN EXPLORES POSSIBLE LONG-TERM
SOLUTIONS. THE MAIN PROBLEM IS SEEN TO BE ONE OF
DEVISING AN ASSET OR A RANGE OF ASSETS THAT WILL
GIVE THE OPEC CREDITOR COUNTRIES LARGELY WHAT THEY
WANT IN TERMS OF SECURITY OF CAPITAL FLOW, YIELD AND
LIQUIDITY WHILE AT THE SAME TIME OFFERING THE
DEBTOR COUNTRIES REASONABLE PROTECTION AGAINST
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PAGE 04 EC BRU 07139 02 OF 02 072052Z

DISRUPTION OF THEIR ECONOMIES THROUGH CAPRICIOUS OR
DESTABILIZING CAPITAL MOVEMENTS AND AGAINST EXCESSIVE
CONCENTRATION OF FOREIGN OWNERSHIP INNARROW SECTORS
OF THEIR ECONOMIES. HARTMAN

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